BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001

REGULATIONS ESTABLISHING SYSTEM OF RATEMAKING	))	Docket No. RM2007-1

TESTIMONY OF DANIEL C. EMENS ON BEHALF OF JPMORGAN CHASE & CO.

July 9, 2007

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Good afternoon, Chairman Blair and members of the Commission. My name is Dan Emens. I am Senior Manager with Chase Card Services at JP Morgan Chase. On behalf of Chase, I would like to thank the Commission for allowing me to testify today. I commend the Commission for its inclusive approach to developing a modern system of rate regulation under the Postal Accountability and Enhancement Act.

I. PERSONAL BACKGROUND

My career in the direct marketing industry spans over twenty years. I have worked in lettershop operations, print, customer services, sales management, marketing communications, corporate procurement and operation functions. I joined JPMorgan Chase in 2003 in the Marketing Operations team of Chase Card Services, headquartered in Wilmington, Delaware. In my current role with Chase, I manage several marketing operational areas supporting campaign execution and delivery across several lines of business, Card Services and Retail, within the Bank. These include both customer programs (i.e., marketing to existing Chase credit card customers) and acquisition based programs (marketing to potential new banking customers). I also represent the Bank's interests in postal matters, including management of its Negotiated Service Agreement ("NSA") with the Postal Service.

Before joining the Bank, I was Procurement Director at AT&T, with offices at its corporate headquarters in Bedminster, NJ. In this capacity I was responsible for all supplier relationships supporting the marketing operation of AT&T, including procurement of media, direct mail, print, market research and partnership/co-marketing arrangements across the businesses.

II. ABOUT JPMORGAN CHASE

JPMorgan Chase & Co. is a leading global financial services firm, with assets of $1.4 trillion and operations in more than 50 countries. Chase is a leader in investment banking, financial services for consumers, small business and commercial banking, financial transaction processing, asset management, and private equity. The Bank has its corporate headquarters in New York, its United States retail financial services and commercial banking headquarters in Chicago, and its card services headquarters in Wilmington. Under the JPMorgan and Chase brands, the firm serves millions of consumers in the United States and many of the world's most prominent corporate, institutional and government clients. The publicly traded common stock of Chase is a component of the Dow Jones Industrial Average.

Chase relies heavily on mail, predominantly letter sized First-Class Mail and Standard Mail, to solicit new customers and deliver customer correspondence, billing statements and remittance. In 2006, the Bank mailed approximately three billion pieces of marketing mail, approximately two billion pieces of which were Standard Mail and one billion pieces of First-Class Mail. Nearly all of this mail was letter-shaped, presorted and automation compatible.

Because of our heavy reliance on mail, Chase has a strong commitment to the continued viability and financial health of the US Postal Service. We continually partner with the Postal Service to optimize our creative package designs, mail preparation and entry to maximize the quality, cost and speed of the postal communication channel.

At the same time, however, mail is only one of many channels of communication used by Chase, like other major banks and credit card issuers, to reach customers and prospects. These alternate media channels already have become at least as effective from a marketing perspective as Standard Mail, and continue to expand in effectiveness and share of our marketing budget. Additionally, the increased concerns about environmental stewardship, and the "Do Not Mail" legislative activity at the state level, continue to place mail under pressure as a communications medium. The level of our commitment to the mail will depend in large part on the Postal Service's ability to control and manage its costs and provide consistent service performance, and the predictability of future postage rate changes.

III. ISSUES OF PARTICULAR CONCERN

Chase belongs to several trade associations that have participated actively in this rulemaking case. I would therefore like to limit my testimony here to the issues that concern us the most. These involve (1) implementation of the index-based rate adjustment mechanism; (2) other rate regulation issues; and (3) regulation of service performance.

A. Implementation Of The Index-Based Rate Adjustment Mechanism

1. Use of a 12-month average of CPI levels

Chase urges the Commission to calculate the CPI index adjustment based on a twelve-month average of CPI levels, not a snapshot of year-over-year changes in the CPI between a single pair of beginning and end dates. While the two approaches should achieve similar results over the long run, the use of the twelve-month average is likely to produce a much less bumpy and volatile path along the way by damping the short-term oscillations of the CPI index. For Chase and other mailers that operate on an annual budget cycle—i.e., for the mailers that generate most of the Postal Service's volume, reducing the short-term unpredictability of cost increases is extremely important.

2. Frequency of and advance notice for index-based rate changes

For similar reasons, Chase prefers that rate changes of general applicability under the index mechanism be taken once a year, preferably at the same time of the year and ideally in mid-calendar year, a schedule that will provide adequate time for budget planning. In addition, we need more than 45 days notice of rate changes that involve changes in classifications, mail preparation requirements, or intra-class rate design. We emphasize that advance notice of changes in classification and mail preparation requirements is just as important as advance notice of rate changes. We concur in the following comment by one of our trade associations, Association for Postal Commerce:

> However, one of the essential objectives of the PAEA is to provide mailers with "predictability." Predictability involves more than rate changes, and when the Postal Service makes classification changes or changes in rate design, these changes affect mailers every bit as much as the changes in the level of an established rate or discount. Thus, when changes in rate design and associated changes in implementing regulations are contemplated by the Postal Service, advance notice of those possible changes must be given in order that mailers may reasonably anticipate what will be expected of them.

Initial Comments of Association for Postal Commerce (April 6, 2007), p. 11.

We recognize that the new law does not require the Postal Service to give the Commission or mailers more than 45 days advance notice of such changes. The Postal Service has stated, however, that it intends to provide more than 45 days notice when the complexity of the rate and/or classifications changes requires a longer period. We urge the Commission to work with the Postal Service to make this commitment work effectively.

3. Transition to index-based ratemaking

Chase commends the Commission for seeking to provide a smooth transition between the old and new regulatory standards. We would oppose the filing of another rate case under the old law, a course that would be disruptive to both mailers and the Commission. Furthermore, when the Postal Service files its first rate increases under the new rules, the Commission should make sure that the timing and level of the increases does result in a double recovery of costs already reflected in the test year revenue requirement of the last omnibus rate case under the old law.

B. Other Rate Regulation Issues

1. Promoting competition for upstream functions

Competition among our suppliers is the most effective tool available to Chase for controlling its costs. Postal costs are no exception. Although the Postal Service has a monopoly over the delivery of First-Class and Standard Mail letters, there is plenty of potential competition for the sorting, transportation and other functions that occur before delivery. We urge the Commission to make sure that this competition is as effective as possible. To quote a lawyer well known to this Commission, "experience teaches in other regulated industries that the most effective regulator is competition. That competition provides a better control of costs, monopoly profits and quality than even the most farsighted and hardworking regulators." PRC-USPS Summit Meeting – Postal Customer Needs In A Changing Regulatory Environment (March 13, 2007), Tr. 155 (statement of David M. Levy). That statement has certainly been true in the Bank's experience in the industries where it operates.

Achieving this outcome requires that postal rates satisfy what economists call the Efficient Component Pricing Rule. In plain English, the extra amounts charged by the Postal Service for sorting, transportation and similar functions must reflect all of the extra costs that the Postal Service incurs for this work.

The Commission recently called the Efficient Component Pricing Rule a "bedrock" principle of ratemaking. We agree. And we urge the Commission to enforce rules for the pricing of sorting, transportation and other competitive functions to ensure that effective competition not only survives but flourishes.

2. Negotiated Service Agreements

Today, five years after the Commission first allowed the Postal Service to offer Negotiated Service Agreements ("NSAs") to individual customers, only five domestic mailers in the United States are parties to an NSA. Chase is one of those five. By contrast, I understand that the railroad industry signed several *thousand* NSA-like agreements with its customers within a few years after gaining permission to do so.

Why has the rollout of NSAs been so limited? Permit me to offer answer from the perspective of a customer who has experienced the regulatory process first-hand.

First, gaining regulatory approval of an NSA can be slow, costly and unpredictable. The signed contract is only the beginning of the process. Players with no meaningful economic stake in the NSA can intervene in the case and force the NSA proponents to endure months—or, in our case, almost two years—

of time-consuming litigation. And even when all of the mailers, competitors, labor unions and other interest groups that have intervened in the case agreed to the NSA terms negotiated by the parties, the Commission may modify the terms on its own. These delays, costs and uncertainties greatly reduce the attractiveness of NSAs for a potential customer.

Second, the rules adopted by the Commission to reduce the financial risk of NSAs to the Postal Service have, paradoxically, *increased* the risk that the potential financial benefits will never be fully realized. Our NSA is a good example. Even though no participant in the case asked for this step, the Commission limited the total volume incentive discounts available to us to the amount of the estimated cost savings to the Postal Service. We reached the discount cap midway through the second year of the three-year NSA. When the rate incentives to use First-Class Mail were exhausted, First-Class Mail immediately became uneconomic for solicitations to many of our target markets, and much of our solicitation mail volume migrated back to Standard Class Mail. We have continued to abide by the mail preparation terms of the NSA. But the reversion of much of our solicitation mail to Standard Mail from higher markup First-Class Mail has deprived the Postal Service of several million dollars of additional contribution to institutional costs (essentially common overhead costs) that the Service would have received if the NSA discounts had been uncapped.

Thanks to the new legislation, the law for the first time explicitly recognizes the appropriateness of NSAs. Our postal counsel also tells me that the adoption of index-based ratemaking insulates other mailers from the profitability of NSAs.

If the Postal Service strikes an imprudent deal with an NSA partner, the Postal Service cannot raise other rates to cover the shortfall. I urge the Commission to use the new law as an occasion to reconsider the wisdom of the current restrictive approach to NSAs, and to give the Postal Service more flexibility to strikes deals with its customers, just as Chase and most other American businesses do.

C. Regulation Of Service Performance

The new law calls for a new system for measuring the Postal Service's actual mail delivery performance. Chase is an active and committed participant in the ongoing deliberations within the MTAC 114 sub-groups focused on developing recommendations for both First Class and Standard Class mail performance standards and measurement approaches. We have appreciated the opportunity to have our voice heard and acknowledge the open, frank and constructive dialog in which the Postal Service and members of the Commission's staff have participated in these meetings. Chase urges the Commission to adopt a performance measurement system that is timely, accurate, resistant to manipulation by interested parties (the Postal Service, its mailers, and third-party vendors), and sufficiently granular to provide performance data by three-digit ZIP Code pairs. We also urge the Commission and Postal Service to make collected data aggregated at the 3-digit level available to mailers online at no cost, preferably in as close to real time as possible. This approach would provide some degree of forward predictability, and assist both the Postal Service and the mailing community to plan and adjust better to evolving circumstances within the network.

Some parties have urged the Commission to impose financial penalties on the Postal Service for non-compliance with specified service standards. We do not believe that this should be a high priority. First, imposing penalties for failure to meet performance standards requires deciding what minimum standards the Postal Service should meet. This is likely to be a time-consuming and contentious process. Second, until the Postal Service accumulates a significant nest egg of retained earnings, financial penalties imposed on the Postal Service will effectively be borne by mailers instead – through poorer service performance as the Postal Service's resources are diverted to penalty payments or, in an extreme case, by giving the Postal Service a pretext to invoke the exigency clause.

Instead, we believe that the Commission should give first priority to establishing a measurement system whose reports are clear, public, up-to-date and reliable. If the Postal Service's service performance deteriorates, the glare of adverse publicity is likely to be the most effective sanction. At the same time, we encourage the Commission to allow the Postal Service, to the maximum extent permitted by law, to retain the earnings generated by good performance through bonuses and incentive payments to postal management and labor.

Finally, the Commission needs to link its performance measurement system to the CPI rate adjustment index, so that the Postal Service cannot evade CPI-based price caps by letting quality slide or outsourcing more of its work to its customers without compensation. Charging the same price for mail service that is poorer in quality, or requires additional mail preparation by mailers without appropriate rate discounts, is effectively a rate increase.

In summary, JPMorgan Chase believes that we all share an opportunity to develop rules and regulations under the new law to ensure that the Postal Service evolves as a customer centric organization, positions itself as a value-added partner with the mailing community and public at large, and designs its product offerings to be consistent with the changing needs of the consuming public as expressed through the market. This regulatory structure, if designed correctly, should lead to a vibrant and financially healthy enterprise that provides value to the American people.

I would be happy to answer any follow-up questions the Commission may have.